

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
UGO AND LEONORA CIANCIOSI	:	
for Redetermination of Deficiencies or for	:	
Refunds of Personal Income Tax and	:	
Unincorporated Business Tax under Articles 22	:	
and 23 of the Tax Law for the Years 1980	:	
through 1982.	:	

DETERMINATION

In the Matter of the Petition	:
of	:
LEONORA CIANCIOSI	:
for Redetermination of a Deficiency or for	:
Refund of Personal Income Tax under Article 22	:
of the Tax Law for the Years 1980 through 1982.	:

Petitioners, Ugo and Leonora Ciaciosci, 405 Anderson Road, Vestal, New York 13850, filed a petition for redetermination of deficiencies or for refunds of personal income tax and unincorporated business tax under Articles 22 and 23 of the Tax Law for the years 1980 through 1982 (File No. 802791).

Petitioner Leonora Ciaciosci, 405 Anderson Road, Vestal, New York 13850, filed a petition for redetermination of a deficiency or for refund of personal income tax under Article 22 of the Tax Law for the years 1980 through 1982 (File No. 802792).

A consolidated hearing was held before Timothy J. Alston, Administrative Law Judge, at the offices of the Division of Tax Appeals, 164 Hawley Street, Binghamton, New York, on June 5, 1989 at 1:15 P.M. and continued to conclusion at the same location on June 6, 1989 at 9:15 A.M., with all briefs to be submitted by January 11, 1990. Petitioners appeared by Frederick A. Griffen, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Deborah J. Dwyer, Esq., of counsel).

ISSUES

- I. Whether the Division properly determined additional tax due from petitioners.
- II. Whether the Division properly imposed fraud penalty herein pursuant to Tax Law § 685(e).
- III. Whether the Division's assertion of negligence penalty pursuant to Tax Law § 685(b) as an alternative penalty to fraud was proper where notice of such asserted penalty was given in summation at the close of the hearing.

FINDINGS OF FACT

Petitioners, Ugo and Leonora Ciaciosi,¹ jointly filed New York State resident income tax returns for each of the years at issue as follows:

<u>Year</u>	<u>Filing Date</u>
1980	January 25, 1982
1981	December 27, 1982
1982	November 5, 1984

During the years in question, petitioner was involved in three businesses. First among these was a sole proprietorship known as Ugo J. Ciaciosi Insurance Agency, located at 156 Vestal Parkway East, Vestal, New York. Petitioner had been licensed as an insurance agent and/or broker since 1952. Petitioner became an insurance agent soon after receiving his

B.A. degree in business in 1952. During the years at issue, petitioner employed a secretary to assist him in this otherwise sole business endeavor. In connection with his insurance business, petitioner sold various types of insurance, received premium payments from policy holders, and sent renewal notices to policy holders. Petitioner maintained a separate insurance broker account at the Bank of New York for his insurance business. In 1980, credit advances totalling \$7,644.00 were made to this account. This account was audited by the Division in connection

¹Leonora Ciaciosi is a petitioner herein solely by reason of her having filed joint returns with her husband. Accordingly, unless otherwise indicated, all references to petitioner herein refer to Ugo Ciaciosi.

with the audit herein and no irregularities in respect of petitioner's use of said account were found.

Also during the years in question petitioner owned and operated a sole proprietorship known as Vestal Tax Service. Petitioner operated this business out of his insurance agency's offices at 156 Vestal Parkway East, Vestal, New York. Vestal Tax Service was in the business of preparing income tax returns for individuals. It is unclear from the record precisely when petitioner became involved in the tax return preparation business, but it appears that petitioner went into the business at some point prior to the years at issue. Initially, petitioner had a partner in the tax service business, one Henry Fiacco. Petitioner, however, supervised the business from his office at 156 Vestal Parkway East, collecting fees from customers and paying the employees. Mr. Fiacco apparently worked elsewhere. At some point in 1980 or 1981, petitioner and Mr. Fiacco terminated their relationship with respect to the tax preparation business. Petitioner, however, continued his involvement in the tax service as a sole proprietor and continued to run the business as he had done previously.

Petitioner's third business enterprise during the years at issue was used car sales. Petitioner apparently became involved in selling used cars in 1981. At that time, petitioner was not licensed as a dealer by the Department of Motor Vehicles. He became involved in the car selling business by purchasing vehicles at dealer auctions. Petitioner held himself out as a dealer at these auctions. He used a friend's "dealer's card" which authorized petitioner as (an apparent) dealer, to purchase cars at these auctions. Petitioner then turned these cars over to licensed dealers for sale. During 1981, petitioner's personal checking account revealed purchases of eight cars totalling \$15,630.00 in connection with his car business. No evidence was presented herein as to car sales in 1981. In August 1982, petitioner became licensed as a dealer by the Department of Motor Vehicles, and conducted his car sales business at his 156 Vestal Parkway East offices under the name "Lee's Used Cars".

Petitioner did not file a separate Schedule C in respect of the tax preparation business for the years 1980 and 1981. Rather, on his returns for those years, he combined the receipts

and expenses in respect of the tax business and the insurance business on a single Schedule C for each year which listed only the insurance agency as the name and type of business. The business activity in respect of the car sales for 1981 was not reported at all.

Petitioner prepared his own returns for 1980 and 1981. His 1982 return was prepared by his attorney.

For 1982, petitioner reported on separate Schedule C's his insurance, tax preparation and car sales businesses.

As noted previously, petitioner maintained a bank account at Chemical Bank in connection with his insurance business. Petitioner also maintained, at various points during the period at issue, two checking accounts at Endicott Trust Company (Account Nos. 473-2010136 and 473-2001609) and an account at Key Bank (Acct No. 453-010464). In addition, petitioner maintained, at various times during the audit period, 17 savings accounts which are listed below:

Schedule of Savings <u>Accts.</u>	Acct. #
1. Key Bank (Bankers Trust)	453-010464
2. Binghamton S.B. (5 yr. C/D)	05-800624-9
3. Binghamton S.B. (5 yr. C/D)	05-618978-8
4. Endicott Trust Co.	473-1209869
5. Endicott Trust Co.	471-1210453
6. Endicott Trust Co.	471-5223290
7. 1st Fed. Bank (Delaware S.B.)	37-980-4364
8. 1st Fed. Bank (Delaware S.B.)	37-980-4363
9. 1st Fed. Bank (Delaware S.B.)	37-150-3563
10. 1st Fed. Bank (Delaware S.B.)	37-150-3561
11. 1st Fed. Bank (Delaware S.B.)	37-150-3564
12. 1st Fed. Bank (Delaware S.B.)	37-150-3566
13. 1st Fed. Bank (Delaware S.B.)	37-100-4349
14. 1st Fed. Bank (Delaware S.B.)	37-980-4162
15. 1st Fed. Bank (Delaware S.B.)	107-060-3333
16. 1st Fed. Bank (Delaware S.B.)	107-080-334
17. 1st Fed. Bank (Delaware S.B.)	107-080-0726

Interest income to petitioner in respect of the various savings and checking accounts during the years at issue and interest income reported by petitioner on tax returns for those years is set forth below:

	<u>1980</u>	<u>1981</u>	<u>1982</u>
Total interest income from			

savings and checking accts.	\$4,738.00	\$7,508.00	\$7,081.00
Total interest reported per returns	<u>557.00</u>	<u>1,137.00</u>	<u>2,046.00</u>
Difference	\$4,181.00	\$6,371.00	\$5,035.00

Petitioner also maintained numerous savings accounts jointly with his mother, Angelina Ciaciosi. In addition, he maintained other savings accounts jointly with his mother and his brother, Mario Ciaciosi. (During the period at issue, Mario Ciaciosi was a resident of Texas.) On audit, the Division determined the total deposits and total withdrawals with respect to eight joint accounts maintained by petitioner and his mother during the audit period. This analysis revealed \$9,848.00 in withdrawals and \$14,186.00 in deposits in 1980; \$11,254.00 in withdrawals and \$23,032.00 in deposits in 1981; and \$40,565.00 in withdrawals and \$26,744.00 in deposits in 1982. Petitioner and his mother jointly maintained several other savings accounts during the period at issue. These other accounts were not analyzed by the Division during its audit.

On audit, none of the accounts jointly held by Angelina Ciaciosi and petitioner were used to determine petitioner's total bank deposits and withdrawals under the Division's audit analysis herein.

Petitioner's mother was of advanced age during the period at issue. Petitioner assisted his mother in paying her bills by accompanying her to the various locations where she would make the necessary payments. Sometimes petitioner paid his mother's bills with his own funds and was later reimbursed by her. Petitioner's mother died in January 1987.

On audit, petitioner advised the auditor that, during the period at issue, he had received money from his mother.

A \$6,000.00 bank check, dated June 17, 1982 and payable to petitioner, was drawn from a savings account jointly held by petitioner and his mother (First Federal Account No. 37-100-5247). Said check was subsequently endorsed by petitioner and paid by First Federal. A \$5,000.00 bank check, dated October 22, 1982, payable to petitioner was drawn from a First Federal savings account jointly held by petitioner and his mother (First Federal Account No. 37-

150-4037). Petitioner subsequently endorsed said check and deposited it in his checking account on October 22, 1982.

Petitioner's name was also on three other First Federal Savings accounts: 1) No. 1070801918 opened 7/18/78 and closed 1/13/81 for \$3,083.13; 2) No. 1070200416 opened 1/24/73 and closed 1/28/81 for \$6,674.12; and 3) No. 1070801582 opened 2/10/78 and closed 2/21/80 for \$3,028.97. The record fails to disclose whether these funds were transferred to another account or, if such transfers were made, to what account the transfers were made. The record also fails to show in whose name or names these accounts were held, e.g., petitioner alone, petitioner and his wife, or petitioner and his mother.

Petitioner and his wife had five children, Patrice, David, John, Steven and Daniel. One of petitioner's sons attended LeMoyne College in Syracuse, New York during 1980 through 1982. All five children were claimed as dependents on petitioner's 1980 and 1981 tax returns. Petitioner claimed four of his children as dependents on his 1982 return.

During the period at issue, petitioner also owned rental property located at 372 Third Avenue, Vestal, New York.

Since 1975, petitioner consistently late-filed both his Federal and New York State income tax returns. The approximate date of preparation of his Federal returns for the years 1975-1980, together with the reported adjusted gross income for each year, is set forth below:

<u>Year</u>	<u>Approx. Date Return Prepared</u>	<u>Adjusted Gross Income Reported</u>
1975	12/17/76	\$2,014.00
1976	12/27/77	2,020.00
1977	12/27/78	1,889.00
1978	12/31/79	(35.00)
1979	12/30/80	(19.00)
1980	1/29/82 (Filing Date)	1,737.00

The Initial Audit

The audit herein was commenced by an interview of petitioner at his place of business on October 17, 1983. At that time, petitioner had not yet filed his 1982 income tax return. On audit, the Division correctly determined that petitioner maintained no books of original entry in respect of his various businesses. Additionally, petitioner maintained banking records for only

a portion of the period at issue and cancelled checks for only a portion of the audit period. As a result, it was necessary for petitioner and the Division to obtain information directly from the various banks with whom petitioner did business. Petitioner was cooperative with the Division in attempting to obtain this information and was generally cooperative with the Division throughout the course of the audit.

On audit the Division attempted to reconstruct petitioner's income by means of the source and application of funds method. The auditor's initial source and application analysis, dated January 17, 1984, is summarized below:

Sources of <u>Funds</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
1. Net Profit Per Return "Sch.C"	<1541>	<1217>	-0-
2. Depreciation	1955-	1968	-0-
3. Interest Expense Per Return	165-	413	-0-
4. Rental Income	752-	831	-0-
5. Rental Depreciation	600-	600	-0-
6. Stock Dividends (gross)	2169-	1653	-0-
7. Gambling Winnings Per Return	-0-	2366	-0-
8. Withdrawals From Savings	7691	24936	61267
9. Decrease in Ck. Acct's	7478	-0-	4450
10. Decrease in Bk. of NY	-0-	7051	1592
Total Sources of Funds	19,269	38,601	67,309
Applications of <u>Funds</u>			
1. Deposits in Savings	39033	23096	64361
2. Total Personal Cks. Written	27864	51164	67568 Est.
3. Increase in Ck. Acct's		510	-0-
4. Increase in Bk. of N.Y.	6690	-0-	-0-
5. E.F. Hutton Margin Acct. Increase	--	--	16878
6. Personal Living by Cash	<u>17,177</u>	<u>17,177</u>	<u>17,177</u> Est.
Total Applications of Funds	90,764	91,947	165,984
Overapplications of Funds	71,495	53,346	98,675

Sources of Funds numbered "1" through "7" above are not in dispute. In fact, "1" through "7" were taken from petitioner's filed returns. (At the time the initial source and application was prepared, the 1982 return had not been filed.) Source "8", "Withdrawals from Savings" was determined by adding withdrawals made from each of the savings accounts maintained by petitioner and listed in Finding of Fact "8". Sources numbered "9" and "10" were determined by a review of the balance in these accounts at the beginning and end of each year in

question. Sources "8", "9" and "10" were determined by a review of available bank records.

On the applications side, Application "1", "Deposits in Savings", was determined by adding deposits to each of the savings accounts listed in Finding of Fact "8". Applications numbered "3" and "4" were determined by a review of the balance in these accounts at the beginning and end of each year in question.

Application "5" was determined by a review of petitioner's E.F. Hutton account. The amount of this application was based upon the fair market value of the account at the end of 1982, and was made up of the following:

Cash reserve	\$ 1.00
135 shares IBM	\$12,993.00
100 IBM Calls	\$ 875.00
150 shares NYS E & G	\$ 3,243.00
99 shares Safeguard Bus.	\$ 2,351.00
66 shares Safeguard Bus.	\$ <u>255.00</u>
Market Value	\$19,718.00
Less: Debit owed	\$ <u>2,840.00</u>
Fair Market Value	\$16,878.00

Application "2", "Personal Checks Written", was determined by calculating total deposits to petitioner's checking accounts and subtracting business expenses claimed on petitioner's Schedule C's and rental expenses claimed on petitioner's Schedule E's, with adjustments for claimed depreciation and increases or decreases in the checking accounts. This calculation is summarized below:

	<u>1980</u>	<u>1981</u>	<u>1982</u>
Total Deposits-Endicott Trust Ck. Acct. 473-2010136	23810	72787	98158
Total Deposits-Endicott Trust Ck. Acct. 473-2001609	16477	-0-	-0-
Total Deposits-Bankers Trust 96-0054-9	<u>10952</u>	<u>9110</u>	<u>2437</u>
Total Deposits	51239	81897	100595
Business Expenses per Sch. "C"	31460	30622	48493
Less: Depreciation	<u>1955</u>	<u>1968</u>	<u>4409</u>
Net Sch. "C" Expenses	29505	28654	44084
Rental Expenses Per Return	1948	2169	2914
Less: Depreciation	<u>600</u>	<u>600</u>	<u>1465</u>
Net Rental Expenses	<u>1348</u>	<u>1569</u>	<u>1449</u>
Total of Net Sch. "C" and Rent Expenses	30853	30223	45533
Gross Personal Expenses By Check (Total Deposits Less Total Net Expenses)	20386	51674	55062

<Increase> or Decrease Ck. Acct Bal. 473-2010136	3853	<369>	4450
473-2001609	2904	-0-	
96-0054-9	<u>721</u>	<u><141></u>	<u> </u>
Total Personal Chks. Written	27864	51164	59512

Application "6", "Personal Living by Cash", was determined by an analysis of petitioner's personal checks written for 1980.² Based upon discussions with petitioner, the auditor estimated petitioner's total personal expenses for 1980. The personal living by cash for 1980 represents the difference between estimated total personal living expenses and personal living expenses paid by check.

PERSONAL LIVING <u>EXPENSES</u>			
	<u>Check</u>	<u>Cash</u>	<u>Total</u>
Food	155	4845	5000
Housing:			
Mtg. payments	2283		2283
Taxes	2934		2934
Utilities	2039	461	2500
Auto Expense:			
gas, oil			
repairs			
insurance	1741	1259	3000
Dept. Stores (Clothing)	1254	746	2000
Medical Expenses	1254	246	1500
Insurance	1530		1530
Education:			
College	1106	6894	8000
Porocial School	1500		1500
Contributions	374	126	500
Personal Assets:			
1976 Pacer	1649		1649
Income Tax	1276		1276
Loan Payments	2243		2243
Miscellaneous	<u>6526</u>	<u>2600</u>	<u>9126</u>
Total Personal Living Expenses	27864	17177	45041

²On audit, petitioner's cancelled checks for 1980, 1981 and 1982 were available for the auditor's review. The checks for 1981 and 1982 were determined by the auditor to be incomplete.

Having determined that checks available for the remaining years at issue were insufficient to perform the same analysis for 1981 and 1982 as was performed with respect to 1980, the Division used the personal living by cash figure for 1980 for both 1981 and 1982.

The Criminal Matter

Given the degree of understatement of income per the above source and application analysis, petitioner's failure to file (at that time) his 1982 New York State personal income tax return (see Finding of Fact "1"), and petitioner's omission of interest income from his returns (Finding of Fact "9"), the Division referred the instant matter to the office of the Attorney General for criminal prosecution. Petitioner was subsequently charged in the Vestal Town Court, Vestal, New York, with felony tax evasion charges in respect of his alleged underreporting for 1980 and 1981. He was also charged, pursuant to Tax Law former § 695(a), with a misdemeanor charge of attempting to evade tax in respect of 1982. A preliminary hearing on the felony charges was held at the Vestal Town Court, Vestal, New York on June 19, 1984.

On November 8, 1984 in Vestal Town Court, petitioner pled guilty to the above-noted misdemeanor charge of attempting to evade tax in violation of Tax Law former § 695(a). The felony charges against petitioner were dismissed. The charge to which petitioner pled guilty alleged the following:

"On or about April 15, 1983, the defendant, with intent to evade personal income tax, did fail to pay such tax and did fail to make, render, sign and certify any return and declaration of estimated income and did fail to supply any information within the time required by Section 651(a)(1) of the Tax Law."

Petitioner elected to enter his plea of guilty upon advice of counsel and upon acknowledgement and waiver of his rights to a trial on the charge.

Also on November 8, 1984, petitioner was sentenced by the Vestal Town Court to a conditional discharge for a period of one year in respect of his misdemeanor conviction. Petitioner was neither fined nor incarcerated in respect of his conviction. Petitioner agreed to attend conferences with the Division to attempt to reach an agreement in respect of his New

York income tax liability for the years 1980 and 1981. Petitioner and the Division retained all their rights and remedies in challenging or enforcing any deficiency assessment for 1980 and 1981.

Petitioner entered his guilty plea following extensive discussions among petitioner's representative, the Attorney General's office and the New York State Insurance Department. Petitioner's representative advised the Insurance Department of the charges pending against petitioner and of the circumstances surrounding such charges. Petitioner's representative sought to determine whether a guilty plea to the misdemeanor charge would jeopardize petitioner's insurance license. Petitioner's representative received assurances, following a satisfactory audit of petitioner's insurance broker account by the Division, that petitioner's insurance license would not be in jeopardy. Such assurances were a factor in petitioner's decision to plead guilty to the misdemeanor charge.

It should be noted that at the time petitioner was charged with the felonies for 1980 and 1981 and the misdemeanor for 1982 and continuing through his guilty plea and sentencing in respect of the misdemeanor, the Division was alleging an underreporting of taxable income for the years 1980 through 1982 based upon its initial source and applications analysis summarized in Finding of Fact "20". This alleged underreporting totalled \$223,516.00 over the three years in question. It should be further noted that, during the pendency of the criminal proceedings petitioner had not filed his 1982 income tax return.

The Notice of Deficiency

Following the conclusion of the criminal matters, the Division reviewed certain additional information provided by petitioner. Such additional information resulted in a revised source and application of funds analysis as follows:

Sources of <u>Funds</u>	<u>1980</u>	<u>1981</u>	<u>1982</u>
1. Net Profit per Return Sch "C"'s <1484>	<1541>	<1217>	
2. Depreciation	1955	1968	4409
3. Interest Expense Per Return	165	413	-0-
4. Rental Income	752	831	<86>
5. Rental Depreciation	600	600	1465

6. Stock Dividends	2169	1653	3583
7. Gambling Winnings Per Return	-0-	2366	-0-
8. Withdrawals from Savings	42789	24936	61267
9. Decrease in Ck. Accts.	7478	-0-	4450
10. Decrease in Bk. of NY (Ins. Acct)	-0-	7051	1592
11. Sale of Stock	-0-	4133	20097
Total Sources of Funds	54367	42734	95293
<u>Applications of Funds:</u>			
1. Deposits in Savings	39033	23096	64361
2. Total Personal Cks. written	27864	51164	59512
3. Increase in Checking Accts.	-0-	510	-0-
4. Increase in Bk. of NY Ins. Acct.	6690	-0-	-0-
5. E.F. Hutton Margin Acct. Increase	-0-	-0-	16878
6. Personal Living by Cash	<u>13362</u>	<u>13362</u>	<u>13362</u>
Total Applications of Funds	86949	88132	154113
Excess Applications (Additional Income)	32582	45398	58820

The changes in this revised source and application analysis result from:

- 1) An increase in withdrawals from savings by \$35,099.00. Additional information revealed the existence of three more bank accounts in petitioner's name. These accounts, which totalled \$35,099.00 were closed in 1980, and the funds withdrawn therefrom.
- 2) Information regarding petitioner's sale of certain stock which resulted in additional sources of income for 1981 and 1982.
- 3) A downward adjustment to the estimated total personal checks written figure for 1982.
- 4) A downward adjustment of \$3,815.00 per year in personal living by cash based upon information that petitioner received \$1,100.00 per year in cash from his mother as reimbursement for payment of real estate taxes and also based upon information that petitioner's education costs for his son had been overestimated by \$2,715.00 per year.
- 5) Petitioner's filing of his 1982 return allowed for the use of amounts set forth on that return under various categories of "sources" of income.

Following the above-noted adjustments to the source and applications audit, the Division issued to petitioner a Statement of Personal Income Tax Audit Changes, dated February 28, 1985, which set forth the Division's assertion of a personal income tax deficiency against petitioner as follows:

	<u>1980</u>	<u>1981</u>	<u>1982</u>
1. Additional Income (As Determined by Source and Application Method)	32,582	45,398	58,820
2. Exemption Disallowed	750	750	800
3. Additional Interest Income (Allocated Between Husband and Wife)	1,812	2,617	1,495
	<u>1980</u>	<u>1981</u>	<u>1982</u>
Per Audit	4,738	7,508	7,081
Per Return	<u>557</u>	<u>1,137</u>	<u>2,046</u>
	4,181	6,371	5,035
4. Capital Loss Allowed	-----	-----	(3,000)
5. Itemized Deduction Allowed	(3,250)	(3,150)	1,749
	<u>1980</u>	<u>1981</u>	<u>1982</u>
Per Audit	5,150	5,150	5,150
Per Return	<u>1,900</u>	<u>2,000</u>	<u>6,899</u>
	<u>3,250</u>	<u>3,150</u>	<u>1,749</u>
Net Adjustment	31,894	45,615	59,864
Taxable Income Previously Stated	(5,313)	(2,880)	(7,840)
Corrected Taxable Income	26,581	42,735	52,024
Tax on Corrected Taxable Income (IT-250)	2,281	4,533	5,713
Corrected Tax Due	2,281	4,533	5,713
Tax Previously Computed	-0-	-0-	-0-
Total Additional Tax Due	2,281	4,533	5,713

On September 27, 1985, the Division issued to petitioners Ugo and Leonora Ciancesi a Notice of Deficiency which asserted \$12,527.00, in additional personal income tax due, plus a 50% fraud penalty and interest, for the years 1980, 1981 and 1982. Said notice was premised upon the Statement of Audit Changes dated February 28, 1985.

It should be noted that in the Statement of Audit Changes the Division allowed itemized deductions of \$5,150.00 for each of the years in question. The Division determined these amounts to be reasonable under the circumstances. These estimated deductions consisted of the following:

<u>Deduction</u>	<u>Amount</u>
Real Estate Taxes Paid	\$2,000.00
Sales Taxes Paid	500.00
Medical Expenses	150.00
Charitable Contributions	300.00
Mortgage Interest & Expense	<u>2,200.00</u>
	5,150.00

On his return, petitioner claimed the standard deduction of \$1,900 and \$2,000 for 1980

and 1981, respectively. The estimated itemized deduction thus allowed an additional \$3,250.00 and \$3,150.00 in deductions for those respective years.

For 1982, petitioner claimed itemized deductions of \$6,899.00, consisting of \$2,508 in claimed medical and dental expenses, \$1,862 in total taxes, \$2,192 in interest expenses, and \$337 in contributions. The Division, however, allowed deductions of only \$5,150.00, resulting in an increase of \$1,749 in petitioner's audited taxable income for 1982.

The additional interest income resulted from petitioner's underreporting of interest earned during the years at issue (see Finding of Fact "9").

It should be noted that the allocation of interest between petitioner and his wife and the personal exemption disallowance resulted from the Division's recomputation of tax herein which was based upon a "married filing separately" filing status. This allocation of interest income and exemption disallowance is not in dispute herein. The capital loss allowance is likewise not in dispute.

Following the issuance of the Notice of Deficiency, the Division further adjusted petitioner's personal living expenses downward for each of the three years at issue based upon an additional reduction in education costs. This reduction, in turn, reduced the total applications of funds and excess applications for each of the years at issue. The Division also reduced the E.F. Hutton margin account increase asserted to be an application of funds for 1982. These adjustments are summarized below.

	<u>1980</u>	<u>1981</u>	<u>1982</u>
Corrected Taxable Income per Statement of Audit Changes	26,581.00	42,735.00	52,024.00
Reduction in personal living expenses (education costs)	(1,825.00)	(1,660.00)	(1,565.00)
Reduction in E.F. Hutton Margin account increase		<u>(8,439.00)</u>	
Recomputed Taxable Income	24,756.00	41,075.00	42,020.00
Recomputed Tax Due	2,025.84	4,310.50	4,442.80

With respect to the reduction in the E.F. Hutton Margin account increase, the Division conceded that petitioner acquired the shares of New York State Electric and Gas and Safeguard

prior to the year in question. This was the basis of the Division's adjustment with respect to this calculation. (Although why such proof resulted in a 50% adjustment and not an adjustment proportional to the value of the NYS G&E and Safeguard stock is unclear.)

Regarding the remaining items in the E.F. Hutton account, petitioner purchased the 100 IBM calls on credit. Also, petitioner purchased the 135 shares of IBM on October 15, 1979. Petitioner reported dividends in respect of these IBM shares on his 1980 and 1981 returns.

Subsequent to hearing, the Division conceded that certain automatic credit advances made to petitioner's Endicott Trust Checking account should have been considered as a source of funds. This is so since total deposits in checking accounts included such credit advances. As noted in Finding of Fact "24", total checking deposits less expense per returns resulted in total personal checks written which was considered an application of funds under the method employed herein. This conceded adjustment is summarized below:

	<u>1980</u>	<u>1981</u>	<u>1982</u>
Recomputed Taxable Income (per Finding of Fact "42")	24,756.00	41,075.00	42,020.00
Conceded Reduction based on credit advances	(<u>31.00</u>)	(<u>1,012.00</u>)	(<u>3,955.00</u>)
Taxable Income as asserted by Division subsequent to hearing	24,725.00	40,063.00	38,065.00

Related Notices of Deficiency

On September 27, 1985, the Division issued to Ugo and Leonora Ciaciosi a Notice of Deficiency which asserted \$841.00 in unincorporated business tax (UBT) due, plus fraud penalty and interest, for the year 1980. This notice was premised upon the results of the personal income tax audit of petitioner discussed herein. Pursuant to the adjustments to the personal income tax deficiency made subsequent to issuance of the notice, the UBT deficiency was also adjusted downward to \$768.60, plus fraud penalty and interest. Additionally, the adjustments conceded by the Division subsequent to hearing with respect to 1980 will adjust petitioner's taxable business income downward by an additional \$31.00 with a corresponding adjustment to the UBT deficiency.

Also on September 27, 1985, the Division issued to petitioner Leonora Ciaciosi a

Notice of Deficiency which asserted \$191.00 in personal income tax due, plus minimum interest, for the years 1980, 1981 and 1982. This deficiency was based on the Division's allocation of additional interest income found on audit (see Finding of Fact "9") to petitioner Leonora Cinciosi. Such allocation apparently resulted from the Division's recomputation of tax due herein as if petitioners had filed separate returns. Petitioner Leonora Cinciosi conceded liability with respect to this Notice of Deficiency.

Summary of Adjustments to Audit Proposed by Petitioner

Petitioner contended that the Division improperly failed to make several additional adjustments in the calculation of audited taxable income.

(a) The \$11,000.00 in bank checks to petitioner from accounts jointly held by petitioner and his mother constituted a nontaxable source as a gift or loan from the mother (see Finding of Fact "14").

(b) \$1,749.00 in deductions claimed on petitioner's 1982 return should be allowed. Petitioner claimed \$6,899.00 in deductions on his return; the Division allowed \$5,150.00 (see Finding of Fact "39").

(c) The remaining \$8,439 asserted as an application in connection with petitioner's E.F. Hutton account should be deleted as an application since petitioner acquired the 135 shares of IBM stock prior to the period at issue (see Finding of Fact "44").

(d) \$15,630 in purchases of used cars in 1981 (see Finding of Fact "4") should be allowed as a deduction. Under the Division's analysis, these purchases were included in "Personal Checks Written" (see Findings of Fact "24"). Such purchases should properly be deductible, petitioner contended, as the cost of goods sold.

(e) Petitioner also claimed as a nontaxable source of funds gifts from his mother (in addition to the \$11,000 discussed in paragraph "48[a]"). For 1980 and 1981, petitioner claimed \$9,848.00 and \$11,254.00, respectively, in such gifts. This amount was based upon the auditor's calculation of total withdrawals made from the incomplete list of petitioner's mother's accounts (see Finding of Fact "10"). For 1982, petitioner claimed \$14,000.00 in gifts from his

mother. This amount was based upon the mother's estimate, made by affidavit, that "in some years" cash given to petitioner was "at least \$20,000.00 to \$25,000.00". The \$14,000.00 claimed amount constitutes the difference between the mother's estimated total of \$25,000.00 in gifts during that year and the \$11,000.00 in checks payable to petitioner with funds from the so-called mother's accounts (see Finding of Fact "14").

(f) The \$7,644.00 in credit advances to petitioner's Bank of New York insurance fiduciary account in 1980 should be allowed as a nontaxable source of funds for that year (see Finding of Fact "2").

(g) Petitioner also contended that withdrawals of \$3,083.00 closing out First Federal account no. 1070801918 and \$6,674.12 closing out First Federal account no. 10200416 should be allowed as a nontaxable source for 1981. Also, a withdrawal of \$3,028.00 closing out First Federal account no. 1070801582 should be allowed as a source for 1980 (see Finding of Fact "15").

CONCLUSIONS OF LAW

A. The Division of Taxation is authorized to examine a taxpayer's return to determine the amount of tax due from the taxpayer and to issue a Notice of Deficiency where such examination reveals an underreporting of tax (Tax Law § 681[a]). The taxpayer then has the burden of proving at hearing that the deficiency is erroneous (Tax Law § 689[e]; Matter of Scarpulla v. State Tax Commn., 120 AD2d 842, 502 NYS2d 113).

B. Petitioner has failed to show that any adjustment in the deficiency is warranted with respect to any purported transfers of funds from petitioner's mother to petitioner (see Paragraphs "48[a]" and "48[e]").

Petitioner's failure to prove the claimed adjustments outlined in paragraph "48(e)" results from a complete absence of any documentation noting transfers from the mother's accounts to petitioner (except in respect of the amounts claimed in paragraph "48[a]" discussed below). The absence of such documentation compels the conclusion that petitioner has failed to establish the existence of any specific transfers of funds to him from the so-called mother's

accounts (except as to paragraph "48[a]"). Indeed, the claimed amounts of these transfers are purely speculative. The gift amounts for 1980 and 1981 are based upon the Division's incomplete calculation of total withdrawals from the mother's accounts. This claimed amount is inconsistent with petitioner's own testimony that he often took his mother to various locations where she would make payments of bills. Petitioner's own testimony would therefore seem to indicate that certain of the withdrawals were made by the mother for the mother's bills. For 1982, the purported amount of gifts to petitioner was based upon Angelina Ciaciosi's affidavit wherein she estimated gifts of \$20,000.00 to \$25,000.00 per year. The total gift amounts in the affidavit are apparently based upon the affiant's general impressions and recollections. There is no documentation in the record to support the affidavit. The claimed \$14,000.00 in gifts in 1982, based upon the affidavit, is thus, at best, an unsupported guess.

With respect to the \$11,000.00 in bank checks claimed as a nontaxable source in paragraph "48(a)", it must be noted that all of the accounts referred to herein as the mother's accounts were jointly held by both petitioner and his mother. Petitioner could therefore have deposited and withdrawn his own funds to such accounts if he so chose. It is noted that petitioner testified herein that he never deposited any of his own money into the accounts jointly held with his mother. Such testimony, however, by itself, is insufficient to establish this claimed adjustment. Petitioner's testimony was generally vague and was frequently characterized by a failure to recall many specific aspects of both his business practices and personal finances during the period at issue. It is therefore concluded that petitioner's testimony was unreliable. Consequently, given that petitioner jointly held the accounts from which the \$11,000.00 was withdrawn, given the absence of corroborating documentation and given petitioner's unreliable testimony, petitioner's contention that the \$11,000.00 constituted a loan from his mother must be rejected.

C. Petitioner also failed to show that the adjustment of \$1,749.00 in respect of his 1982 itemized deductions was warranted. As petitioner presented no evidence supporting his claimed deductions for that year, the Division's allowance of estimated itemized deductions for 1982

will not be disturbed.

D. Petitioner also failed to show that the adjustments as outlined in paragraph "48[g]" were warranted. Petitioner contends that these funds were deposited prior to the years in question, withdrawn as the accounts were closed and immediately transferred to one of the savings accounts analyzed on audit (see Finding of Fact "8"). In order to be considered a nontaxable source of funds, petitioner must prove that these funds were in fact deposited prior to the years in question and were transferred to one of the savings accounts analyzed on audit. The record herein merely discloses that the funds were withdrawn. In the absence of additional documentation, this adjustment cannot be made.

E. Petitioner has shown that the following adjustments are warranted:

(1) The remaining \$8,439.00 asserted as an application for 1982 in connection with the E. F. Hutton margin account should be deleted. The record herein shows that the 135 shares of IBM were purchased in 1979 and that the 100 IBM calls were purchased on credit (Finding of Fact "44"). Since the Division conceded that the remaining components of the E. F. Hutton account were purchased before the year in question (Findings of Fact "23" and "43"), this account no longer constitutes an application.

(2) The \$15,630.00 in used car purchases in 1981 is properly deductible as cost of goods sold for that year. The Division contended that such an adjustment was improper in the absence of sales records and a schedule C filing for that year. The record, however, is clear that the purchases in question were made and that petitioner was in the used car business in that year. Moreover, the gross receipts from the sales of the cars have presumably been accounted for on audit in the form of savings deposits or checking account increases. The Division thus improperly failed to allow this adjustment.

(3) Finally, the \$7,644.00 in credit advances in 1980 to petitioner's Bank of New York insurance fiduciary account should be allowed as a nontaxable source of funds for that year. These advances or loans resulted in the \$6,690.00 increase in the account balance over the course of the year.

F. If any part of a tax deficiency for any given year is proven to have been due to fraud, a penalty equal to 50 percent of the tax is added to the deficiency (Tax Law § 685[e]). The Division has the burden of proving fraud (Tax Law § 689[e][1]). A finding of fraud requires "clear, definite and unmistakable evidence of every element of fraud, including willful, knowledgeable and intentional wrongful acts or omissions constituting false representations, resulting in deliberate nonpayment or underpayment of taxes due and owing" (Matter of Ilter Sener d/b/a Jimmy's Gas Station, Tax Appeals Tribunal, May 5, 1988 citing Matter of Walter Shutt and Gertrude Shutt, State Tax Commn., June 4, 1982). Circumstantial evidence of fraud is permitted and fraud may be properly inferred where a taxpayer's entire course of conduct establishes the necessary intent (see Intersimone v. Commr., 53 TCM 1073). Mere suspicion of fraud is insufficient to establish a fraudulent intent (Goldberg v. Commr., 239 F2d 316).

G. With respect to the years 1980 and 1981, it is concluded that the Division of Taxation has failed to sustain its burden of proving that its imposition of fraud penalty was proper.

The Division contended that its assertion of fraud was supported by a number of factors present in the record. Primary among these factors was the purportedly consistent and substantial underreporting of income by petitioner. In order to constitute evidence of fraud, underreporting must be affirmatively proven by the Division (Matter of Cousins Service Station, Inc., Tax Appeals Tribunal, August 11, 1988). The Division thus cannot rely upon petitioner's failure herein to meet his burden under Tax Law § 689(e) to disprove the tax deficiency in order to meet its own burden to prove fraud under Tax Law § 689(e)(1).

Here, the tax deficiencies are derived, in large part, from estimated personal living expenses, estimated cash living expenses, estimated itemized deductions, and an apparently incomplete listing of bank accounts. Except for the relatively small amounts of interest income which petitioner failed to report (Finding of Fact "9"), the Division has failed to affirmatively prove an underreporting of income by petitioner.

The Division also contended that certain other facts present in the record supported its imposition of the fraud penalty. Specifically, the Division noted petitioner's poor

recordkeeping; his failure to file separate schedule C's in respect of his tax return preparation and insurance business for 1980 and 1981; his failure to file a schedule C for 1981 in respect of his used car business; and his consistent late-filing of returns. The Division also noted that petitioner was college-educated and owned a tax return preparation business. As a result, the Division contended that the requisite elements of knowledge and intent must be inferred from the above-noted improprieties.

Among the many factors which have been considered to be evidence of fraud is the taxpayer's experience and knowledge which indicates a familiarity with the Tax Law (see Matter of AAA Sign Company, Tax Appeals Tribunal, June 22, 1989). However, the record herein fails to establish a level of experience or knowledge of the Tax Law on petitioner's part from which a fraudulent intent may be inferred (cf. Dajos v. Commr., 51 TCM 1648; Rinehart v. Commr., 45 TCM 1185). Also absent from the record is the extent of petitioner's involvement in the preparation of tax returns for his business. The record thus reveals a taxpayer who was either ignorant of or indifferent to his responsibilities under the Tax Law. The record does not, however, establish a fraudulent intent on petitioner's part.

Also weighing against the Division's imposition of the fraud penalty was petitioner's cooperative conduct during the course of the audit. Petitioner provided records upon Division request during the audit and attempted to obtain records from his various banks. Petitioner thus made no apparent efforts to hide records from the Division. Such conduct implies an absence of a willful intent to conceal income (cf. Gromaki v. Commr., 361 F2d 727).

In sum, the evidence presented falls well short of affirmatively establishing a specific intent to deliberately evade payments of taxes due and owing in respect of 1980 and 1981. The Division's imposition of the fraud penalty for these years was therefore improper.

H. With respect to 1982, petitioner's conviction on tax evasion charges estops petitioner from contesting the civil fraud penalty for the same period (see Matter of Michael J. Fahy, Tax Appeals Tribunal, April 5, 1990). This is so since petitioner's "failure to pay [income] tax with intent to evade" such tax (see Finding of Fact "28") is the determinative fact in both the criminal

matter and the instant matter. It is noted that the charge to which petitioner pled guilty charged petitioner with not only a failure to file a return with intent to evade tax but also a failure to pay tax with intent to evade. A voluntary plea of guilty to a criminal charge estops petitioner in the same manner as a conviction following a trial on the merits (Plunkett v. Commr., 465 F2d 299 [7th Cir 1972]). Here, the record is clear that petitioner's guilty plea was voluntary. There is therefore no reason to look behind the guilty plea, as petitioner urges, to reconsider whether petitioner was, in fact, guilty of tax evasion under Tax Law former § 695(a) with respect to 1982, and also to consider whether, on the record herein, the Division has met its burden of proving fraud with respect to 1982.

I. Having rejected the Division's assertion of fraud penalty for 1980 and 1981, it is necessary to consider the propriety of the Division's assertion, during summation at hearing, of the negligence penalty pursuant to Tax Law § 685(b).

The Tax Appeals Tribunal has determined that, under certain circumstances, the Division of Taxation may assert penalties alternative to fraud outside the usual notice of determination/deficiency procedure (see Matter of Ilter Sener d/b/a Jimmy's Gas Station, supra; Matter of Anton's Car Care Center, Ltd., Tax Appeals Tribunal, November 23, 1988). Where the Division properly asserts an alternative penalty outside the normal procedure, it bears the burden of proof (Matter of Ilter Sener, supra). Both of the above-cited cases involve the assertion of late-payment penalty in sales tax (Tax Law § 1145[former (a)(1)]) as an alternative to fraud penalties assessed in notices of determination. In both cases, the Tribunal's resolution of the issue centered upon the adequacy of notice to petitioners of the alternative penalty. In Matter of Ilter Sener (supra), the Tribunal concluded that the assertion of the lesser penalty in the Division's answer gave the petitioner adequate notice. In Matter of Anton's (supra), the Tribunal found that the Division's assertion of the alternative penalty in a post-hearing brief did not provide petitioner adequate notice and concluded that the assertion of the penalty was improper.

J. In the instant matter, the alternative penalty was asserted at the close of the hearing

during the Division's summation. At that point each side had presented evidence in an effort to meet their respective burdens regarding the purported tax deficiencies and fraud penalty. Thus, at the time each side presented its evidence, the negligence penalty had not yet been asserted. Under these circumstances, it must be concluded that notice of the negligence penalty was inadequate, for petitioner and his representative were deprived of an opportunity to prepare and present a defense to the lesser penalty (see Matter of Anton's Car Care Center, Ltd., supra). This constitutes a substantial disadvantage or prejudice to petitioners. The Division's assertion of negligence penalty herein was therefore improper.

K. With respect to the Notice of Deficiency for Unincorporated Business Tax (Finding of Fact "46"), such notice must be adjusted in accordance with Finding of Fact "46" and Conclusion of Law "E(3)". The fraud penalty asserted in said notice is cancelled in accordance with Conclusion of Law "G".

L. The petition of Ugo and Leonora Cianciosi is granted to the extent indicated in Findings of Fact "45" and "46" and in Conclusions of Law "E", "G", "J" and "K"; except as so granted the petitions are in all other respects denied; and, except as so adjusted, the notices of deficiency issued September 27, 1985 are sustained.

M. The petition of Leonora Cianciosi is denied and the Notice of Deficiency dated September 27, 1985 (see Finding of Fact "47") is sustained.

DATED: Troy, New York

ADMINISTRATIVE LAW JUDGE